Linklaters

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Insurance Update.

The effects of pension reform in Poland on the Pension Funds and Life Insurance business

The Polish government has introduced reforms which are aimed at improving the state budget, but which, with effect from the start of this month, have resulted in lower amounts contributed in respect of pensions actually reaching Polish pension funds. The effects of the reforms are broadly that fewer contributions will ultimately be passed to the pensioner (or their dependants) and that a greater proportion will therefore be ultimately credited to the State. An example of the consequences of the reforms is that certain amounts may cease to be payable to children in the event of death of the pensioner and instead directed to the State.

In the short term, the reform will have the positive effect of improving state finances. However, the reforms will result in a reduction in the amounts invested in pensions which may even have an adverse impact on the development of financial markets as pension funds will have fewer financial resources to invest. More specifically, in relation to the insurance sector, there will be less money flowing into open pension funds. This may not affect larger pension providers (including insurers) which maintain themselves chiefly from management charges as opposed to the amount of funds themselves under management (although the amount of management charges is likely to reduce as a result). However, smaller pension providers (including insurers) largely depend for their existence on ongoing contributions and may suffer (or even be forced to close or be sold) as a result of the decline in the amounts invested. In addition, where a pension provider is an entity within an insurance group, these reforms may have an adverse impact in group capital as a whole.

In the near future, a constitutional appeal is planned with the aim of postponing the effects of the reform, or having the reform declared unconstitutional. However, given the important state interest in the reform, we expect that this appeal will only have a small chance of success.

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Developments in India

Insurance Regulatory and Development Authority's order on third party motor pool reserves and account reserves

The Indian Insurance Regulatory and Development Authority has issued directions to all general insurers following concerns that the amounts reserved in respect of the Indian motor third party insurance pool were significantly lower than the ultimate loss ratio. The pool was established collectively by all general insurers in India, at the direction of the Authority, to service the commercial vehicle third party insurance business by making available third party insurance to all commercial vehicle owners. The new directions provide that the insurers must:

> maintain the revised solvency ratio as prescribed in the order, which increases solvency ratios to be maintained over successive years as follows: not less than 130% for all lines of business as at 31 March 2011; and not less than 137%, 145% and 150% respectively as at 31 March 2012, 31 March 2013 and 31 March 2014; and thereafter the ratio has been fixed at an uniform rate of 150%;

> submit a financial plan to the Authority within two months from 12 March 2011 (i.e. until 11 May 2011) setting out how they intend to correct any solvency ratio deficiency;

> not declare dividends in any year where the solvency ratio is below 150% without prior approval of the Authority;

> appoint full-time, qualified and experienced property and casualty actuaries;

> not provide performance incentives (e.g. bonuses) to key personnel, senior management, appointed actuaries or full-time directors with prior approval of the Authority;

> not exceed the limitation on management expenses that is set out in rule 17E of the Insurance Rules 1939. and

> submit a quarterly report on accounting transactions to the Board of Directors as prescribed under Circular No. IRDA/009/F&U/07-08 dated 14 May 2007 along with the relevant board resolution within 30 days of the end of each quarter.

The Authority may review the applicability of these above directions to a specific general insurer where that insurer maintains a 150% solvency ratio on a consistent basis.

Guidelines on distance marketing of insurance products

On 6 April 2011, the Insurance Regulatory and Development Authority issued guidelines on Distance Marketing of Insurance Products which will come into effect on 1 October 2011. These regulate the use of distance marketing by insurance companies, insurance brokers and corporate agents. The guidelines stipulate that distance marketing, which includes phone calls, SMS and emails, can only be carried out by the employees of insurance companies, insurance brokers or specified persons of corporate agents or telemarketers that are registered with the Telecom Regulatory Authority of India.

Key measures introduced by the guidelines include that:

> insurers or brokers will be responsible for all acts carried out or omitted to be carried out by persons employed by them, including telemarketers;

> brokers will be required to suggest the best available products in the market that suit the needs of the client and not endorse the products of any particular insurer; and

> no remuneration, other than the brokerage fee, will be paid to the brokers.

The guidelines also prohibit distance marketing of certain insurance products, such as unit-linked insurance policies of non-single and single premium types with annualised premiums that exceed Rupees 50,000 and Rs 100,000 respectively.

This article has been provided by Talwar Thakore & Associates. TT&A is a "best-friend" of Linklaters.

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Taiwan FSC amends regulations to enhance insurance industry

In order to enhance the supervision of insurance intermediaries and establish sound supervision of reinsurance business, the Taiwan Financial Supervisory Commission has, respectively:

> amended the Regulations Governing Insurance Agents, the Regulations Governing Insurance Brokers and the Regulations Governing Insurance Surveyors in order to strengthen the function of their trade associations, improve consumer safeguards and ensure more sound regulation of insurance channels. Key amended regulations include:

- trade associations are required to publish membership information on their websites;
- insurance brokers and agents are not allowed to authorise any third party to carry out their business activities on their behalf; and
- persons without proper qualifications may not be hired to solicit insurance business.

> amended the Regulations Governing Insurance Enterprises Engaging in Operating Reinsurance and Other Risk Spreading Mechanisms and

the Regulations Governing the Financial and Business Operations of Professional Reinsurance Enterprises to enable life insurers to spread risk and enhance capital by removing long-term life insurance risks through reinsurance arrangements.

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Developments in Singapore

I. The Singapore MAS publishes its response to its consultation paper on the proposed framework for reinsurance management

On 1 April 2011, the Monetary Authority of Singapore (MAS) issued its response to the consultation paper on the proposed supervisory framework governing reinsurance management of insurers, which was published on 30 June 2010. Reinsurance management refers to the oversight and control of outward reinsurance arrangements.

Key proposals in the June 2010 consultation paper included:

> requiring a direct insurer to submit information on its outward reinsurance arrangements on an annual basis (the first set of returns was proposed to be due in May 2011); and

> removing the need to seek MAS's approval before entering into financial reinsurance arrangements in respect of life insurance business.

Except that the submission timeline in respect of the first set of new returns will be extended to 30 June 2011, the proposals have remained largely unchanged in MAS' response. The MAS has, however, provided certain clarifications, including:

> the applicability of the rules and acceptable risk management practices;

> reporting requirements for reinsurance management, in particular the audit and disclosure requirements for direct insurers and the definition of "accounting period";

> assessment of significant risk transfer and unfair terms and conditions;

> disclosure requirements for reinsurance financing contract that does not involve significant risk transfer; and

> the extent of MAS power to adjust capital relief for outward reinsurance arrangements.

The new framework for reinsurance management came into force from 1 April 2011, with the issuance of a new Notice MAS 114 replacing the previous Notice MAS 114 dated 28 March 2002.

II. MAS issues the Third Consultation Paper on Policy Owners' Protection Fund

On 12 May 2011, MAS issued the Third Consultation Paper on Policy Owners' Protection Fund and seeks comments by 15 June 2011.

The first and second consultation papers, discussing key policy proposals relating to the Policy Owners' Protection Scheme (PPF Scheme), were issued in December 2005 and December 2009, respectively. The Third Consultation Paper sets out:

> the revised target fund sizes and levies for PPF Life and PPF General Funds using data from insurance companies as at the end of 2009;

> proposals on the disclosure requirements in relation to the PPF Scheme; and

> the proposed rules for PPF Scheme members.

It is proposed that the fund sizes will be increased from S$60 million (for the PPF Life Fund) and S$16 million (for the PPF General Fund) to S$345 million and S$24 million, respectively.

MAS is proposing a risk based levy structure that is less differentiated across the different risk rating categories. In addition, MAS is proposing to maintain the cap on levies payable by an insurer at 1% of the insurer's gross premium income in the preceding year ending 31 December.

This article has been provided by Allen & Gledhill LLP. Allen & Gledhill is Linklaters' joint venture partner in Singapore.

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Developments in Hong Kong

I. FSTB launches consultation paper on policyholders' protection fund

On 25 March 2011, the Hong Kong Financial Services and Treasury Bureau (FSTB) published a consultation paper on the proposed establishment of a policyholders' protection fund aimed at providing a safety net for policyholders against insurer insolvency.

Key proposals in the consultation include:

> the fund will comprise of two separate and independent schemes, namely the Life Scheme and the Non-Life Scheme, to cover life and non-life insurance polices respectively;

> the initial target fund size will be HK$1.2 billion for the Life Scheme and HK$75 million for the Non-Life Scheme, with both planned to be built up over a 15 year period;

> the initial levy rate for both Schemes will be set at 0.07% of the applicable premiums;

- the limit on the compensation to be paid by the fund will be set at 100% for the first HK$100,000 of the claim, plus 80% of the balance, up to a total of HK$1 million;
- in cases of insurer insolvency, the fund will need to establish a method of transferring certain policies to another solvent insurer; and
- the fund will be established by statute and administered by a governing body to be appointed by the Financial Secretary.

The consultation closes on 24 June 2011.

II. FSTB outlines legislative proposals to enhance regulation of MPF intermediaries

On 28 March 2011, the FSTB submitted a paper to the Hong Kong Legislative Council's Panel on Financial Affairs on the legislative proposals to enhance the regulation of the sales and marketing activities of Mandatory Provident Fund (MPF) intermediaries. The Mandatory Provident Fund is a compulsory saving scheme for the retirement of residents in Hong Kong.

Key proposals include:

- prohibitions against engaging in regulated MPF sales and marketing activities other than by registered MPF intermediaries;
- conduct requirements for MPF intermediaries and relevant guidelines;
- regulatory scope, supervisory and disciplinary powers of the Hong Kong Insurance Authority, the Securities and Futures Commission and Hong Kong Monetary Authority to promote compliance with the conduct requirements governing the sales and marketing of MPF products; and
- transitional arrangements for pre-existing registered MPF intermediaries.

The FSTB aims to introduce a bill into the Hong Kong Legislative Council later this year with a view to implementing the legislative amendments in mid-2012.

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Chinese Insurance Asset Management Companies

The China Insurance Regulatory Commission (CIRC) has introduced changes to the rules regulating insurance asset management companies (IAMCs) with the intention of developing them from pure "insurance" asset management companies to comprehensive asset management platforms, introducing further competition within China's asset management market.

The new rules, together with the CIRC's approval at the end of 2010 of Sino Life's establishment of an IAMC, suggests that there may shortly be a second wave of approvals for new IAMC in China. The first round of IAMC approvals took place between 2003 to 2006 when nine IAMCs and one insurance asset management centre were approved and, since then, the CIRC has effectively suspended further approvals of new IAMCs.

Highlights of the key changes introduced include:

> expanding the permitted business scope of an insurance asset management company to include management of non-insurance funds from third parties.

This is an endorsement of existing market practice and should further encourage IAMCs to move towards comprehensive asset management platforms. Since 2007, IAMCs have been providing asset management services, such as management of enterprise annuities, for third parties on a contractual basis. Some insurance companies have also obtained approval from the CIRC to create their own asset management products on a pilot basis.

> raising the thresholds for establishing an IAMC:

- the minimum total assets for the primary sponsor of a proposed IAMC are significantly increased. For example, where the sponsor is an insurance holding company, it must have minimum total assets of RMB15 billion (previously RMB10 billion). Where the sponsor is a property insurance company, the minimum level of total assets has been increased to RMB10 billion from RMB5 billion;
- the primary sponsor's solvency ratio must not be lower than 150% (previously 100%); and
- the minimum registered capital of the proposed IAMC must not be lower than RMB100 million (previously RMB30 million).

Given the increased thresholds, it will now be more difficult for small and medium size insurance companies or groups to establish their own asset management companies.

However, while there has been an increase in certain threshold requirements, the new rules lower the track record requirement for the primary sponsor from eight years to five years, allowing relatively new market entrants to set up IAMCs.

> clarifying that IAMCs will be permitted to set up subsidiaries to engage in special purpose asset management. The detailed requirements for the establishment of a subsidiary, its specific business scope and how it may support the business of an IAMC remain to be clarified.

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CIRC proposes to widen distribution channels for insurance products in China

Since November 2010, insurance companies in China have faced increased restrictions on their ability to distribute their products through the extensive PRC commercial bank network following the introduction of new rules by the China Banking Regulatory Commission (CBRC).

In order to expand the distribution channels available to insurance companies in China, the China Insurance Regulatory Commission has issued draft rules (the Regulatory Provisions on Insurance Companies Engaging Financial Institutions to conduct Agency Insurance Business). Under the proposed new rules, qualified financial institutions (other than insurance companies), such as commercial banks, securities companies, trust companies and fund management companies, will be permitted to distribute insurance products on an agency basis within the PRC. The new rules, when issued, will mark the first time that institutions, such as securities, trust and fund management companies, will be permitted to distribute insurance products on behalf of insurance companies.

To be eligible, financial institutions will need to meet certain requirements, including having relevant qualified personnel and sound management systems. It is currently unclear though whether the industry regulators for each of these financial institutions, for example, the China Securities Regulatory Commission in the case of securities companies, will introduce additional rules to regulate the distribution of insurance products, as the CBRC has done in the case of bancassurance products.

The draft rules were open for public comments until 27 April 2011.

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Successful inaugural insurance roundtable in Hong Kong

We were pleased to welcome a number of Asia insurance general counsels to our inaugural GC Forum for insurers in Hong Kong in May.

Our Hong Kong Financial Regulation Group partner, Umesh Kumar, led the informal discussions, together with London corporate insurance partner, Victoria Sander, Asia insurance sector leader, Teresa Ma and Shanghai corporate managing associate, Eric Liu. Topics included key themes regarding insurance joint ventures in China, regulatory capital - including Solvency II - and anticipated developments in relation to consumer protection. Many of the GCs stayed afterwards for informal drinks, welcoming the opportunity to network with peers. We received a lot of positive feedback, both from attendees and those who were unable to come this time, but are interested in future events. In the Autumn, we propose to run the forum in London and run another one in Hong Kong.

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British Banking Association fails to secure judicial review of the UK FSA rules on assessing PPI complaints

The British Banking Association (BBA) has failed in its attempt to challenge the legality of FSA Policy Statement 10/12 on the assessment and redress of payment protection insurance (PPI) complaints on all three grounds argued. The problem had arisen because, for some years, the FSA has been seeking to require PPI sellers to apply the approach taken by the Financial Ombudsman Service (FOS) in addressing customer complaints.

The BBA first complained that FOS should not apply the principles in assessing compensation because to do so afforded a direct cause of action to customers for breaches of the FSA's principles for businesses (the "Principles") - thus side stepping the rule that individuals have no such right under s150 FSMA. Likewise it was argued that the changes in DISP (Dispute Resolution/Complaints) rules and introducing the so called Open Letter mechanism (a requirement that recipients of the open letter have regard to the "common failings" in the sale of PPI identified by the FSA, as mapped against the Principles and other rules, when assessing complaints) wrongly required the banks to apply the Principles in assessing claims. In similar vein, they secondly argued that the Principles could not be used to contradict or augment specific ICOBs (Insurance Conduct of Business) rules applicable at the time and in accordance with which banks had originally designed their sales processes. It was wrong for the FSA to apply standards contained in the Policy Statement to past sales.

The High Court rejected the suggestion that FOS could not apply the Principles – even if they had not been written down and formally adopted, they were matters which in acting fairly anyone was bound to take in to account. Further, the BBA had got things the wrong way around – far from augmenting/contradicting specific rules, the Principles were the starting point, an "ever-present substrata to which the specific rules are added". Mr Justice Ouseley held that the clearest possible language would be required for a rule to limit the general application of a Principle. The decision supports the view that intrusive and judgment-based supervision allows the FSA to assess not only whether firms are technically permitted to act in a certain way, but whether they should in fact behave that way, taking into account both the spirit and letter of the FSA's Principles and rules.

The High Court also rejected the BBA's third argument that, by requiring firms to consider performing a root cause analysis to discover deficiencies in their sales of PPI and then compelling them to compensate customers who had not complained, the FSA was circumventing the conditions for past business reviews set out at s404 FSMA. This was the very situation which had been contemplated by s404 – ie alleged widespread and regular failure to comply with rules. The BBA's point here was that in asking the Treasury to apply s404 measures the FSA would not have been allowed to specify breaches of Principles; only breaches of specific rules. Mr Justice Ouseley agreed that the FSA could have taken the route afforded by s404. However they were not required to and they were equally free to pursue other routes available. Furthermore, Principle 6 already required banks to look for a root cause where complaints were received on a common issue; the Root Cause Analysis section of the Policy Statement was simply a more "emphatic, impatient and specific" use of the existing DISP provisions.

The judgment reinforces the FSA's focus on principles-based regulation. The FSA press release which followed the High Court's decision makes it clear that the FSA now expects firms to deal swiftly with outstanding complaints about PPI mis-selling and we have seen certain banks make very significant provisions in respect of claims. The decision confirms that, where the rules are silent, the Principles provide considerable scope for a retrospective change in the FSA's expectations. Firms will, to an extent, have to second-guess how the FSA and/or the FOS may use the Principles to augment the rules, if they are to avoid enforcement action. Thus it presents real problems for firms in devising retail sales processes on new products given the possibility that future interpretations and application of the rules and principles may retrospectively designate those processes as inadequate.

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Belgium changes its prudential regulator

Belgium moved to a "Twin Peaks" supervision model on 1 April and this has resulted in the financial sector regulator changing and its role being split into two. The former Banking, Finance and Insurance Commission (now renamed Financial Markets and Services Authority (FSMA)) no longer regulates insurance companies and, broadly speaking, the National Bank of Belgium has assumed responsibility for the macro- and micro-economic stability of the financial system (including the prudential regulation of insurers), whilst the FSMA now supervises the conduct of business of all financial institutions and financial intermediaries, including insurance mediation companies. The actual prudential regulations have not changed as a result of the Twin Peaks model.

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Recent Deals

Our recent deal experience in the sector (details of which we are able to disclose) include:

> advising on the sale of 100 per cent. of the shares of Imperio Assurances et Capitalisation by Eureko B.V. to Société Mutuelle d'Assurance sur la Vie du Bâtiment et des Travaux Publics;

> advising Companhia de Seguros Fidelidade Mundial, together with other insurance companies within the Caixa Seguros Group, on the acquisition of a controlling stake in Universal Seguros, S.A., an Angolan insurance company;

> advising on a number of disposals and acquisitions by international investors in listed and unlisted PRC insurance companies under the new rules issued by the China Insurance Regulatory Commission in 2010;

> advising on the Friends Provident Holdings (UK) plc issue of £500 million 8.25 per cent. subordinated tier 2 notes due 2022 which will be guaranteed by Friends Provident Life and Pensions Limited, the first tier 2 issue by a UK insurer since the QIS5 requirements were published in July 2010;

> advising on acquisitions of interests in New China Life Insurance Co. Ltd.; and

> advising on the Aviva plc issue of £450m Fixed/Floating Rate subordinated tier 2 notes due 2041, the first issue by Aviva plc of capital securities intended to comply with tier 2 capital eligibility requirements under the Solvency II regime of prudential capital requirements.

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